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SUBJECT: MOD BRIEFS ON 2006 DEFENSE PROCUREMENT PROCEDURES

1. (U) Summary. In an October 24 briefing for the diplomatic corps and business community, officials from the Ministry of Defense, including then-Defense Minister Pranab Mukherjee, Defense Secretary Shekhar Dutt, Director General Shilabhadra Bannerjee, and Major General H. S. Sehgal explained the implications of India's new Defense Procurement Policy (DPP), released on August 30, 2006. Minister Mukherjee described the opportunity India has with strong economic growth coinciding with the need to modernize the military, and sees the new defense policy as the chance for India's private sector to become a stakeholder in ensuring the nation's security. Defense Secretary Dutt believes India can take advantage of its "monopoly as a purchaser" and leverage its offset policy to enhance domestic production capabilities. Director General for Acquisitions Bannerjee stressed DPP 2006 was just beginning its implementation phase, and admitted details had not been worked out, but offered government flexibility in interpreting the new rules. Sehgal, the technical expert on the DPP, provided details on it, describing bidding procedures, attempts to improve transparency, the new role of private industry in offset programs, and the different categories for acquisitions, including the new "make" procedures. The briefing answered many questions, but even the GOI admits a lot is yet to be determined in terms of the DPP's implementation. End Summary.

Minister Mukerjee - The Big Picture

12. (U) Defense Minister Mukerjee (Note: Later in the day, Mukerjee was named Foreign Minister. End Note.) explained the broader goal of India's DPP as an effort to enhance the nation's security. Referring to the "right atmosphere and conducive environment," he said the objective was to create a public-private partnerships in the defense sector. By "right atmosphere," Mukerjee noted that defense expenditures have risen by nearly 200 percent since 2000-2001, while economic growth is expected to be in the 9-10 percent range over the next 5-7 years. In terms of "conducive environment," Mukerjee said policymakers have come to realize that India's military could be adversely affected if it comes to rely too heavily on foreign suppliers, and he expects allocation of funds for modernization of India's armed forces to keep pace with the robust economic growth. The new policy, he explained, is designed to "herald a new era in domestic defense production." Under DPP 2006, private industry will be put on an equal footing with defense public sector undertakings (DPSUs), which, he expects, will facilitate foreign investment. With India's defense industry standing to receive up to \$10 billion in offsets between 2007-2012, according to Mukerjee, private industry will become a stakeholder in India's defense. Mukerjee challenged India's private sector to "have a sense of duty" and "live up to the expectations of the nation."

Secretary Dutt - Leveraging Purchasing Power

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13. (U) Defense Secretary Shekhar Dutt, referring to India's plan to upgrade nearly all its defense systems in the next 15 years, suggested India had a "monopoly as a purchaser" and would leverage its purchasing power to acquire a domestic production capability. India's 30 percent offset policy was the result of studying offset policies of over 30 countries worldwide, he said, and is aimed at acquiring production know-how. He noted that some countries have 100 percent-plus offsets, and that India chose 30 percent with the goal of having quality inputs to enhance domestic industry, suggesting that Indian industry would struggle to absorb a higher percentage. DPSUs had been set up in the past as a kind of insurance for limited domestic production, but the GOI now realizes DPSUs can't meet India's production needs, and he called for greater cooperation between DPSUs and private industry.

DG Bannerjee - Implementation Just Beginning

14. (U) MoD Director General for Acquisitions Shilabhadra Bannerjee stated that DPP 2006 was essentially DPP 2005 with adjustments based on feedback received from the 2005 model. He emphasized that the new procedures were just beginning to be implemented, and that the government would review implementation as time went on. The 2006 version merely included detailed guidelines on offsets, he said. The only significant change was the introduction of the "make procedure" category, an addition to the previous "buy" (merely purchasing products and technology) and "buy/make" (purchase from a foreign vendor followed by licensed production/indigenous manufacture) systems; "make" will require certain classes of high tech products, to be determined by MoD, to be designed, developed and produced indigenously. The 2006 revision also included a revision for fast-tracking urgent procurements within six months.

Sehgal - The Details

15. (U) Major General H. S. Sehgal, Technical Manager (Land Systems) and one of the primary architects of the DPP and the

offset policy, gave a detailed powerpoint presentation and said changes to procurement policy (including DPP 2005) were designed to reduce decision-making time, seek multi-vendor procurements whenever possible, enhance transparency and competition, increase the role of Indian industry, and leverage through offsets the high cost of acquiring technology. Under the new procedures, there will be no negotiations on price with the lowest (L1) bidder once the bids are opened, and because bidders now are only required to meet minimal essential parameters -- and not concrete technical requirements, although there will also be "desirable parameters" -- there are no longer provisions for a company's score on the technical trials. The lowest bidder who meets the minimal essential parameters will necessarily be the winning bid. To facilitate bidding, the GOI will introduce a public pre-bid meeting with vendors, and will

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debrief vendors after trials are performed. Foreign vendors will have to provide details on "technical consultants" (read: middlemen/lobbyists) being employed, and all bidders for contracts above 100 crore (approximately \$222 million) will be required to sign an integrity pact. Additionally, bidders will have to guarantee that they are not providing the product at a lower price to another GOI ministry/department.

16. (U) Sehgal clarified that transfers of technology, which had been solely for DPSUs in the past, could now be done via India's private defense industry, elaborating that interested Indian companies would have to apply with the MoD to become a licensed entity. Nearly 20 companies have already qualified, he noted.

17. (U) The 30 percent offset requirement -- 30 percent is the minimum, he stated -- applied only to procurements of over 300 crore (approximately \$667 million). The Defense Acquisition Council, chaired by the Defense Minister, is the body who will decide when offsets will exceed 30 percent. If a country voluntarily offers greater than 30 percent in offsets, it will not receive any additional favorable considerations in its bid per se, however, if the offer supports development of indigenous technology, that case will be weighted heavier than those which do not. India will examine life cycle costs when determining offset values. An offset plan will be required before a Letter of Acceptance (LOA) is signed. Offsets can be directed toward products, components, services or research and development, but must be within India's defense industry. The DPP requires that offsets must be completely discharged before the term of the contract ends. Failure to fulfill offset obligations would result in a company being blacklisted from any future contracts.

18. (U) The "make" category of procurements will ensure indigenous production capabilities of certain high technology, complex systems, Sehgal said. It is aimed at leveraging India's comparative IT advantage in high-tech goods. The "make" category will protect Indian companies from back door entry by a foreign company, Sehgal said. Headquarters of the Integrated Defense Staff will be responsible for determining which projects will be categorized as "make" based on the capability of Indian industry and the desire to achieve self reliance in the equipment in question. The GOI would support up to 80 percent of the Indian entity's development costs, if needed. "Make" will have a minimum order prescribed to assure the original producer of a given revenue.

Comment: Still Not Clear

19. (SBU) Comment: The DPP 2006 is a 253 page document, and while the four-hour session clarified some of the major items, the devil appears lodged in the details. DG Bannerjee himself admitted that DPP 2006 is a work in progress, and one

where the progress had just begun. MoD expects problems as the new policy gets implemented, but Bannerjee promised his office -- and the various related boards which are being created to oversee the procedures -- will vigilantly monitor the situation and be prepared to react to the policy's shortcomings. While the policy is now set, he said, the GOI will be flexible in its implementation, and he encouraged industry reps in the audience to bring forward complaints as they come up. Judging by the questions from the audience, the specifics of the new policy remain murky to the industry -- which will be required to operate under DPP 2006.

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